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UNCLAS SECTION 01 OF 04 BUENOS AIRES 001330

SIPDIS

E.O. 12958: N/A
TAGS: EFIN ECON ETRD PREL AR
SUBJECT: ABOUT-FACE: ARGENTINE PRESIDENT MAKES SURPRISE
ANNOUNCEMENT OF WILLINGNESS TO CONSIDER DEAL WITH BOND
HOLDOUTS

REF: A. BUENOS AIRES 1312
¶B. BUENOS AIRES 1011
¶C. BUENOS AIRES 1303

## Summary

¶1. (SBU) Argentine President Cristina Fernandez de Kirchner (CFK) made a surprise announcement yesterday that the GoA is considering a proposal by three banks to re-open the 2005 debt exchange to holdout bondholders. Barclays, Citi, and Deutsche Bank have developed the proposal, which will cover the roughly $20 billion in bonds that remained untendered in the 2005 exchange. The terms of the proposal will resemble the 2005 restructuring arrangement, but will also bring in billions of new financing for the GoA. As part of the same deal, the three banks will simultaneously restructure the GoA's guaranteed loan portfolio to smooth out the amortization profile for 2009-2011. While there are many unanswered questions and the initiative will likely months to complete, the announcement represents a dramatic change of course for the CFK administration, and together with the September 2 decision to pay all Paris Club debt (Ref A) will help Argentina re-engage with international capital markets. End Summary.

## Cristina Shocks the Markets Again

¶2. (SBU) Just three weeks after the President's surprise September 2 declaration that the GoA will pay Paris Club creditors, CFK shocked the Argentine financial world for a second time September 23, declaring the GoA's readiness to consider re-opening the 2005 debt exchange to holders of untendered defaulted debt (the so-called "holdouts"). She announced the possible initiative during her speeches in New York before the Council of Foreign Relations and later during the closing ceremony of the NASDAQ Exchange. Stating that the GoA is prepared to consider a "very interesting" proposal from "three very important international banks," CFK emphasized that the GoA had not solicited this offer. On the contrary, she noted, the banks had brought the proposal to the GoA and that it was "much more favorable for Argentina than the 2005 debt swap." She said she would personally analyze the proposal and, if acceptable, send it to Congress for approval.

¶3. (SBU) According to Post's private bank sources, GoA

Cabinet Chief Sergio Massa held one-on-one, off-the-record briefings for financial journalists from the major Argentine dailies about the same time that CFK was making the announcement in New York. Massa reportedly outlined the basic structure of the proposal to these reporters, commenting that the GoA was partly motivated to pursue the deal due to concerns about its capacity to meet its debt obligations during 2009 - 2011, when financing needs increase sharply to the range of $10-11 billion per year (from $6-8 billion per year).

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Barclays, Citi, Deutsche Bank Coordinate on Debt Swaps
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¶4. (SBU) As reported in the press and confirmed by Post's banking sector sources, Barclays, Citi, and Deutsche Bank (DB) are the three banks presenting this proposal. The proposal originated with Barclays and U.S. hedge fund Gramercy, which have both worked for almost a year to convince high-level GoA officials to consider reopening the 2005 debt exchange. (Comment: Gramercy officials have been in regular contact with State and Treasury officers on this project, and Post reported status Ref B. The GoA has not officially named any of the three banks, and only a few press articles have mentioned that Gramercy may be involved. End Comment.) Post also understands that Citi-Argentina Managing Director Juan Bruchou recently lobbied CFK to consider dealing with holdout bondholders. According to an Argentine private banker close to the negotiations, the GoA asked Barclays to coordinate on developing a final proposal with Citi and also with DB, which was involved in the GoA's



ill-fated attempt earlier this year to refinance its Guaranteed Loans (see para 6 below).

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Early Details of Debt Swap Proposal
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¶5. (SBU) According to Post sources, the proposal is similar to the original deal offered during the 2005 debt exchange, except that it offers fewer options and also has the key feature of requiring participants to provide billions in fresh financing. The main features are as follows:

-- The aggregate eligible amount included in the 2005 debt exchange was $81.8 billion, comprising $79.7 billion principal and $2.1 billion accrued but unpaid interest as of December 31, 2001. The eligible amount tendered in the 2005 debt exchange was $62.3 billion, representing 76.15% of the total, with untendered securities totaling $19.5 billion (or almost 24% of the total).

-- The value of untendered debt has since risen to over $30 billion, including accrued interest, but the Barclays proposal will apply only to the $19.5 principal.

-- The proposal envisions a swap of the original bonds for U.S. dollar-denominated Discount bonds, maturing in 2033 and issued under international law. It will include a 65% haircut. Therefore, for every $1,000 of original bonds, the bondholder will receive $350 in discount bonds. However, the GoA will recognize interest accrued since the original exchange, which it will pay by issuing additional Discount 33s. This will bring the total value to the range of $500 (or 50% of the face value of the untendered bonds). (During the 2005 exchange, participants received Discounts issued January 2003, with an 8.28% yield, in acknowledgment of interest accrued between the default and 2005 exchange. Participants in the re-opened exchange would also be paid in January 2003 Discounts.)

-- The current market price of USD Discounts is about 70% of face value, while untendered bonds have been trading around

25% of face value (and increased to 27-28 cents on the dollar since CFK's announcement). Swapping $1,000 untendered bonds for the equivalent of about $500 (face value) of USD Discounts, trading at 70% face value, results in an effective value of $350 (35% of $1,000). 35% represents about a 30% premium over the current market price of 27-28 cents/dollar for untendered bonds.

-- For every $1,000 of new USD Discount 33s, participants must agree to purchase $250 of a 10-year, dollar-denominated GoA bond, issued under international law.

-- Still unclear is whether the GoA will agree to attach GDP Warrants to the Discounts. (During the 2005 exchange, participants received 3 GDP Warrants per $100 of Discount 33s, but press reports speculate that the GoA might drop this sweetener this time around.)

-- If 100% of holdouts participate in the renewed exchange, the GoA will have to issue roughly $9 to 9.5 billion in USD Discount 33s, but will also issue a 10-year bond of about $2.25 billion, representing new financing.

-- In addition to Gramercy, which claims to be one of the larger holders of untendered bonds, the Barclays group reportedly has convinced many of the larger holdouts to participate, including Mexican financier David Martinez and Nicholas Stock of Italy. Post's contacts predict that over 90% of holdouts will participate, and that the GoA would try to complete the exchange before the end of the year. (Comment: On August 31, Finance Secretary Hernan Lorenzino predicted to EconOff that if the GoA were to open the debt exchange with an offer similar to the one from 2005, even major litigants EM Ltd (controlled by Kenneth Dart) and NML Capital Ltd (controlled by Elliott Associates) would buy in -- see Ref C for background.)

-- Comment: The GoA cannot accept a proposal that offers a better deal for holdouts than was offered in 2005 without extending it to or facing legal challenges from participants



in the 2005 debt exchange. End Comment.

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Details of Mini-Debt Exchange
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¶6. (SBU) The three banks will simultaneously organize a mini-debt exchange of local debt in order to smooth the GoA's maturity profile for 2009-2011. The timeline will be similar to the larger debt swap: completion before the end of 2008. The GoA first pursued this initiative in March-April 2008, but was stymied when a New York Judge, acting on a Holdout lawsuit, froze a stock of "Global bonds" backing the Guaranteed Loans that were to comprise the majority portion of the exchange.

¶7. (SBU) According to Post's banking contacts, Barclays, Citi, and DB will resurrect this mini-exchange, presenting two distinct options. One will be aimed at foreign owners of the debt instruments that will be exchanged, and the other aimed at local bondholders (although there will apparently not be any restriction on participation in either of the offers).

-- For foreign bondholders, the GoA will exchange USD Discount 33s. For every $100 of Discounts, participants will have to exchange $70 of Guaranteed Loans and $30 new cash.

-- For local holders, the GoA would offer a one-to-one exchange with a five-year peso-denominated bond, adjusted by BADLAR (the interest rate on deposits of over one million pesos).

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Comment
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¶8. (SBU) Citi's Juan Bruchou acknowledged to Charge September 23 that the parties are in the beginning stages of developing this proposal and that it will be a complicated and lengthy process, with many details still unclear. Aside from the numerous questions regarding the specifics of the two debt swaps, the key issue is whether Finance Secretary Lorenzino is right that even EM Ltd and NML Capital Ltd (and the thousands of Italian holdouts) will accept the deal. Although failure to entice them into the deal would not necessarily block the larger debt exchange, their continuing legal efforts to block the exchanges would surely complicate the mini-debt swap.

¶9. (SBU) Post's banking contacts believe that CFK's about-face on holdouts (and to some extent on Paris Club) was born out of necessity: 1) Holdout lawsuits have effectively barred the GoA from international markets, just as its financing needs are expected to spike during 2009-2011; 2) the four-month farm strike weakened the economy and convinced the GoA it could not raise taxes; 3) the August issuance of a dollar-denominated bond, issued under local law, to Venezuela at a yield of almost 15% proved to the GoA that it could no longer rely on Venezuelan financing; and 4) the deteriorating global financial crisis and accompanying flight to quality convinced GoA officials that they needed to act to stabilize Argentina's financial sector and halt the capital outflow.

¶10. (SBU) Regardless of the motivation, Post's local financial sector contacts see this latest initiative as a positive development, as Argentina will be forced to submit somewhat to market disciplines. Significantly, it will also strengthen the political power of the internationally oriented pragmatists who are behind these recent policy shifts (Cabinet Chief Massa, Central Bank President Martin Redrado, and Finance Secretary Lorenzino) -- even as CFK protected her left flank during her September 23 address to the UNGA (septel) by attributing the current financial crisis to what she called the "jazz effect," which she defined as "first economy of the world's" errant belief that "the market would solve everything." Rhetorical feints aside, re-opening the debt exchange and paying the Paris Club will help normalize Argentina's relationship with international capital markets, open access to cheaper financing, lessen concerns about possible default, and should lead to reduced country risk and higher ratings from the ratings agencies -- all of



which will benefit the economy and, especially, the Argentine financial sector.
KELLY